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The Impact of EU Accession on Ship Registration in Malta*

Daniel Aquilina, BA; LL D; LL M (IMLI).

The Maltese political scene is undoubtedly dominated by the frenzied debate concerning Malta's possible full membership within the European Union. Impact Assessments have naturally been carried out for a number of areas, each analyzing the effects of EU accession. One such Impact Assessment is the one studying the effects of the adoption of the EU *Acquis Communautaire* with regard to Ship Registration. In fact, considerable attention is being reserved to the prospected impact of Malta's entry into the EU on the Maltese Shipping Registry.

The Report, commissioned by the Malta Maritime Authority, and now available to the public, is divided into two parts. The first part considers legal issues whilst the second part tackles the economic implications of full membership on the Maltese Shipping Register.

The Report focuses on four main areas:

- a. Ship Registration and associated tax regimes,
- b. Maritime safety and marine pollution prevention in the operation of vessels,
- c. Conditions of Employment of seafarers,
- d. The regime regulating shipping companies.

The relevant EU legislation was identified and subsequently compared and contrasted with the Maltese Merchant Shipping Act, as amended, as well as other relevant subsidiary legislation. The scope of this exercise, the Report states, was to determine the degree of compliance of Maltese legislation with EU law, to identify any deficiencies, to make suggestions and finally, to establish the cost factor involved in respect to their implementation and supervision. The Report was compiled following consultations with various local and foreign legal experts.

The Report tackles key legal issues such as the Right of Establishment, the Freedom of Movement, Crew Nationality and the Transfer of Vessels within Member States. The creation of a Community Ship Register, the 'Euros', was also given its due importance, notwithstanding the fact this concept has now been shelved by the Council of the European

Communities. The Report also deals with the role played by the European Court of Justice in the establishment and strengthening of certain fundamental principles of European law by analyzing a number of landmark judgements.

The importance reserved by Maltese to the shipping sector can be easily appreciated if one realizes that Malta currently boasts the fourth largest register of ships in the world in terms of tonnage. Furthermore, the Maltese shipping industry has not only contributed substantially in providing much needed revenue to our coffers but has also created a good number of working opportunities for locals. It is thus in the national interest for this 'success story' to continue developing positively and for Malta to safeguard its position as a world leader in the field of maritime services. This position guarantees Malta a strong voice in the international arena when it comes to maritime related matters and this factor alone is essential to its interests as a State in general and as an island enjoying the geographical position that it does. It must also be mentioned, however, that the Maltese Registry has navigated through its fair share of troubled waters and in recent times faced an intense image-clearing exercise particularly in the wake of the *Erika* disaster on the 12th December 1999 and the more recent *Kristal* and *Balu* incidents.

The Maltese flag owes its success to a number of factors amongst which; modern and effective legislation, attractive fiscal incentives and the acceptance of the Maltese mortgage system by international financiers. The recent amendments to the Merchant Shipping Act have removed certain cumbersome and frustrating procedures and can generally be regarded as a fine tuning to the Act. Moreover, there are promising signs that ancillary areas may also develop in the near future such as ship management and insurance brokerage services and these would also undoubtedly make their valid economic contribution to the country. The recent amendments to the Merchant Shipping Act clearly reveal the determination of the regulatory authority in Malta to constructively

* This article was published in two parts in *The Malta Independent on Sunday*, 5th August 2001 (Part One), and 12th August 2001, (Part Two). It is to be considered as correct at the time of the publication of this issue of *Id-Dritt*.

rebut allegations that the Maltese flag is one of convenience and to aim for a quality flag and a registry of confidence. The European Union reserves special attention to the Maltese Shipping Registry. In fact, all those Maltese nationals declaring that Malta has nothing to give the EU should think again. Europe has a lot to gain from Malta's accession in relation to the Shipping Registry from three significant aspects. First of all, it would represent a welcome return for European ship owners who currently have their vessels flying the Maltese flag and secondly, together with the accession of Cyprus, it would boost the number of ships registered in European Registries to such an extent that Europe would once again become a major player in the shipping industry following years of difficulties and uncertainty. Finally, the European Union's voting power in the international shipping fora would increase, particularly at the International Maritime Organization (IMO), where international maritime regulations and conventions are created and developed. This voting power is particularly important because Malta and Cyprus represent a very high shipping tonnage.

Maltese registered ships are broadly in line with the provisions of the *acquis*. In its acceptance of the *acquis*, Malta has made it clear, however, that measures to enhance the performance of the Merchant Shipping Directorate with regard to the control of Malta flag ships are well underway. Steps are also being taken to improve the port state control detention rate of Maltese flagged vessels which is considered to be too high (close to 10%) when compared with the current average detention rate of EU vessels (just over 4%). In spite of increased port state control targeting of Maltese ships, particularly in EU ports, the detention rate appears to be steadily on the decline. Generally speaking, no insurmountable hurdles are envisaged for the Malta flag to be in line with European Union requirements, even though it is expected that operating costs will necessarily increase as a result of the role to be played by the MMA particularly in respect to port state control, and to a lesser extent, flag state control.

Factors that a ship owner would, without fail, take into consideration, are the areas of ownership eligibility, operational management of the ship, the popularity or otherwise of the flag with regard to port state control and potential charterers and insurers as well as crew nationality or trading restrictions. Financing considerations would also come into the picture and a ship owner would consider the attractiveness of the flag to potential financiers with regard to the validity and enforceability of mortgages as well as to the costs, time and reliability factors linked to enforcement actions. The taxation of profits, tax treatment in general and the fees charged are also issues taken into account by any ship owner. It is immediately evident that the registration and operation of ships and shipping companies are vital elements in

the study of possible effects of EU accession on the Maltese register.

The Report highlights a few major areas of concern in respect of the shipping sector and these are duly outlined and commented on below.

Preparation and Disclosure of Accounts

In the present scenario, when one registers his vessel under the Maltese flag in the name of a company, there is no requirement, as such, to file accounts with the Maltese Registrar of Companies. Shipping companies registered in Malta today are regulated by the Commercial Partnerships Ordinance, Cap.168 of the Laws of Malta.

The provisions dealing with shipping organizations introduced by the Act amending the Merchant Shipping Act, wherein there is an option for the company to be governed by the said Ordinance or by the Companies Act, 1995, are not yet in force. The Companies Act of 1995, unlike the said Ordinance, is deemed to be EU law compliant.

It is envisaged that the Commercial Partnerships Ordinance will be gradually phased out and thus Maltese companies would be subject to the requirements on disclosure of accounts as required by the Companies Act regime. It is clear that shipping companies formed in the European Union will have to comply with certain requirements of an accounting nature concerning the obligation to prepare and disclose audited financial statements. The EU requires the preparation of annual accounts in the form of a balance sheet, a profit and loss account and notes on the accounts. The annual accounts must then be approved and the annual report, together with the auditor's opinion, must be published according to the laws of the Member State in question. Publication of the annual report may be derogated from by member states yet, it must be made available to anyone wishing to obtain a copy.

The Fourth Council Directive of the 25th July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies (78/660/EEC) allows member states to draw up abridged balance sheets as long as certain conditions are satisfied and also relieves such companies from the obligation to publish their profit and loss account, annual reports and the auditor's opinions. These conditions are mainly concerned with the size of the business since the idea was to allow derogations for small companies. The same Directive also permits medium-sized companies to be exempted from the requirements to disclose turnover and gross margins in their profit and loss accounts and to disclose turnover in the notes to the accounts.

Malta-flag ship owners will find this situation distressing from two separate points of view. First of all, the entire exercise brings about considerable costs and secondly, and prob-

ably more alarming to ship owners, the previous advantage of confidentiality in this respect will vanish into thin air.

The Report recommends that the MMA looks into circumstances where EU companies do not require an audit, as well as into the UK concept of elective resolutions not to publish accounts. The Report also identifies mechanisms created by Greek shipping companies whereby the company is formed outside the EU with a branch duly set up in Greece and with a simple declaration being filed in the registry to the effect that all accounts have been kept and submitted to the competent authorities and are available for inspection. Confidentiality of Beneficial Owners

Another problem area is that of nominee relationships and the confidentiality of beneficial owners which might need to be revised in the near future, due to the pressure being applied by the OECD for the disclosure and identification of ship owners. There is always a possibility that if Malta removes this incentive in the light of EU accession requirements, then ship owners could pull out of Malta and register their ships in non-member registers which can guarantee confidentiality of the beneficial owner. The Report recommends that the MMA, in tandem with the MFSC, continues to monitor international developments closely in order to create and utilize alternative corporate bodies and vehicles such as Trusts or Overseas Holding Companies in anticipation of these fears actually materializing.

Shipping Companies

EU legislation does not explicitly establish the nature of the legal entity required to be set up for the exercise of shipping operations and the matter is left to the discretion of the member states. The amendments to the Merchant Shipping Act have introduced a new corporate body on the local scene in the form of shipping organizations, the specific provisions of which however, have not yet come into force. The overall impact of these organizations is expected to be positive and could be regarded as a welcome solution in the light of the phasing-out of offshore companies.

Furthermore, by virtue of the recent amendments, the shipping company may now be a foreign entity. This is in line with EU principles establishing that the register of a member state must be accessible to all European legal entities. This is a step which may naturally lead to a reduction of ship owning companies incorporated in Malta. The fact that the shipping company may be a foreign entity, however, has its importance and continues to add to the attractiveness of the Maltese flag. It is indeed a pity that the provisions dealing with Shipping Organizations are not yet in force and their introduction and implementation should be encouraged and accelerated.

Registration of Ships and Crewing Requirements

By lowering the age-limit of ships for first-time registration, the Maltese registry shows its manifest intention to achieve higher quality levels, though it must be said that these age levels still contrast with the practice adopted by other Open Registers whose ceiling age for first time registration is still significantly lower than twenty-five years.

With respect to the transfer of ships from the registry of a country to the Maltese registry, this is by no means automatic and the requirements for registration as laid down by Maltese law and by International Conventions to which Malta is a party have to be respected. The relevant certificates must also be produced.

An essential feature of the Maltese Registry, and of the open registry system in general is the fact that no restrictions as to the nationality of crews are imposed. Member states of the EU are free to impose their own requirements pertaining to crewing. The European Commission is determined to safeguard the rights and living conditions of seafarers through the implementation and enforcement of common rules and international conventions at Community level. The MMA-commissioned Report clearly establishes that the Maltese Merchant Shipping Act lacks detailed provisions which reflect the requirements contained in the various EU directives and regulations. However, it must be said that the Act contains a number of enabling provisions empowering the Minister to enact detailed regulations and subsidiary legislation. The Merchant Shipping Act, as amended, now provides that the Minister may make regulations related to, for instance:

- a. the presence of medical supplies and facilities on board Maltese-flagged ships,
- b. safe working conditions on board Maltese vessels,
- c. safe working conditions for Maltese citizens working on foreign ships.

Subsidiary legislation transposing various Directives will also be adopted and will enter into force in the near future, amongst which:

- a. Directive 92/29/EEC (minimum safety and health requirements for improved medical treatment on board vessels),
- b. Directive 99/63/EC (organization of working time of seafarers),
- c. Directive 99/95/EC (provisions in respect of seafarers' hours on board ships calling at Community ports).

It is pertinent to mention, at this stage, that the majority of these provisions, or their equivalent, would have to be implemented irrespective of EU membership due to the coming into force of the 1995 amendments to the International Convention on Standards of Training, Certification and Watch-keeping for Seafarers 1978 (STCW Convention), on the 1st February, 2002.

Taxation Issues

The OECD has vigorously pursued its work in this field with the ultimate goal of establishing a multilateral approach under which countries can operate individually or collectively to limit the extent and effects of harmful taxation practices. The EU has also repeatedly expressed its concern on harmful tax competition. It must be said that Malta has taken a firm stand in this matter and is determined to be in harmony with OECD practices and standards.

Since harmonization and uniformity amongst member states in the field of maritime services has proved to be very difficult, the European Union has not legislated on specific aspects of taxation in the context of maritime law. It is interesting to note, however, that whereas certain member states support their maritime industry through tax reductions, others make direct payments such as reimbursements of seafarers' income tax. The EU Commission increased the use of state aid through guidelines established in 1989 and 1996.

State aid was considered to be fundamental for the operation of ship owners in member states in order for the European fleets to regain some lost ground but the European Commission realized that it must closely monitor the effects of state aid in order to avoid possible distortion of competition between member states. It is interesting to note that the EU takes a clear stand with regard to state aid and deems it acceptable in those cases where:

- safety will be generally improved,
- it leads to the development of maritime skills and preserves maritime know-how within the EU,
- employment within the EU is safeguarded.

The Position Paper on the Transport Chapter of the *acquis* reveals that Malta considers its existing tonnage tax system as compatible with the Community guidelines on state aid to maritime transport, except in the case of registration fees for ships engaging Maltese crew members. This will be brought in line with the *acquis* at a later date through subsidiary legislation under the Merchant Shipping Act.

Zero taxation dominates the international shipping industry nowadays. Zero taxation is the practice of operating in a fiscal climate with little or no tax on profits. The possibilities of establishing a ship-owning business in tax-free yet commercially attractive locations abound and it has now become very difficult for countries where profit taxation is still levied to remain competitive.

EU law views tax incentives or exemptions of this nature as a form of state aid. Whilst being true that member states are free to design and establish their own tax regimes, it must also be noted that forms of state aid such as tax incentives, for instance, require prior approval by the European Commission.

The Maltese Merchant Shipping Act establishes that a ship will be exempt from taxation either when declared to be so by the Minister responsible for Shipping, irrespective of tonnage, operations or trade; or alternatively, when the ship is owned or chartered by a company registered under the Act as long as the registration fees have been duly paid, the vessel is not less than 1,000 net tons and it is engaged in the carriage of goods or passengers. Only those persons ordinarily resident or domiciled in Malta, or a body of persons formed and registered in Malta, or having its principal place of business in Malta, or which is controlled by Maltese residents, may in fact own an exempted ship. Exempt ship owners must submit a declaration to the Commissioner of Inland Revenue instead of a tax return in terms of the Income Tax Act. No tax is charged on the income of a shipping company or on any profits made from the ownership and operation of an exempted ship, or on any dividend paid to shareholders for that matter. Where the shareholder is another company, any dividend paid to the shareholders is not taxable as long as the dividends are paid out of gains and profits derived from the ownership and operation of an exempted ship, or out of such company's share in the profits.

Malta has also ratified a large number of double taxation treaties and other attractive bilateral agreements with other states. Finally, the new provisions of the Merchant Shipping Act concerning shipping organizations, still to come into force, also extend favourable tax conditions to the said organizations. Effects of the Post-*Erika* Proposals

The *Erika 1* and *Erika 2* packages created by the European Commission have far-reaching effects and represent the reaction of the EU to the immense pressure applied by international public opinion in the wake of the *Erika* incident. For illustrative purposes, the post-*Erika* proposals deal with the following issues:

Erika 1 Package:

- Important amendments to the existing directive on classification societies,
- Substantial modification of the existing directive on port state control,
- The phasing out of single hull tankers from EU waters.

Erika 2 Package:

- The creation of a European Maritime Safety Agency,
- Improvements to the system for liability and compensation for oil pollution damage,
- Establishing a new regime for the surveillance and control of navigation in EU waters.

It could be anticipated that the costs incurred by the MMA in implementing EU port state control policies and standards will increase as the Maltese authorities will be determined to maintain a high level of enforcement. Improved port state control mechanisms require more frequent and intense controls

in the quest of eliminating substandard shipping. Expenses incurred by the MMA in enforcing flag state control are also expected to increase as the inspections will be more frequent and possibly of a higher standard.

The phasing-out of single hull tankers is also expected to leave its mark on the Maltese Registry particularly because the number of Maltese-flagged single-hulled tankers over a certain age is considerably high. The accelerated elimination of such vessels could significantly affect the Maltese Registry.

Other EU standards related to maritime safety, marine pollution and the conditions of employment of seafarers are not expected to have any drastic effect on the Maltese Registry except that costs for compliance will inevitably increase.

Malta has already ratified major maritime conventions and is currently modernizing its legislation, an exercise felt necessary irrespective of EU accession. Seafarers' conditions and crew certification procedures must also be reviewed but no drastic changes are envisaged. Replying to a Parliamentary question in May 2001, the Transport Minister stated that a large number of ships were struck off the Maltese shipping register or actually turned away and refused registration following the introduction of stricter measures and the lowering of the maximum age limit in the wake of the *Erika* disaster. These actions translated themselves into a tonnage loss totaling 1.4 million gross tons. There is therefore, an evident determination on the part of the Malta Maritime Authority to ensure that the Maltese flag will not serve as a safe platform for those who do not maintain acceptable standards. The Maltese Government wants to paint a new picture of its Registry and there is a conviction that the standards to be applied could be upgraded to any standard the EU itself is likely to apply.

Malta has accepted the *acquis communautaire* with respect to Transport Policy, except for certain transition periods being requested for certain issues related to land transport.

It may be noted that in respect of the issue of the right of establishment, subsidiary legislation under the Merchant Shipping Act providing for ownership or charter of vessels by EU nationals will be published at a later stage and will enter into force on eventual accession.

The part of the Report dealing with the actual costs in figures to be incurred by the MMA, should Malta become a full member of the European Union, was tackled on a scenario-based approach based on five different percentages of reduction in tonnage on the Maltese Register. From a general perspective, there is no doubt that costs would increase considerably. The fact that such a wide spectrum of scenarios was adopted for the cost-analysis exercise, together with the fact that a number of assumptions were made in respect of the MMA's revenue and expenditure reveal that, as the Report itself states,

any projection of the potential impact of joining the EU on the Malta Register is excessively subjective.

With such a wide spectrum of possibilities being adopted, however, figures and calculations vary considerably and thus, the Report still leaves us with a certain feeling of uncertainty in this respect. It must also be said, however, that clear-cut indications of the economic impact on the Maltese Registry are not possible to obtain at this stage and as such, the decision to work on five different scenarios could be justified in order to cover varying circumstances and percentages of tonnage withdrawal from the Maltese Registry.

Conclusion

Malta is determined to clear its image and reinstate its position as a flag of confidence rather than of convenience, irrespective of EU membership. Malta wants to be a registry of quality and though it is in its interest to also have a registry of quantity, quality must be given absolute priority. The Malta Maritime Authority is gearing itself in preparation for the greatest challenge it has ever faced in recent years.

The European Union itself has realized that over-regulation and the imposition of too many burdens on ship owners would lead to a situation where ship owners will leave Malta, and consequently Europe, and establish themselves in other parts of the world. Ancillary services would also be eventually withdrawn from Europe. Whilst maintaining certain standards, conditions have to remain competitive with those offered by other players in the market.

It is crystal clear, in my view, that there is a very fine line between absolute success and downright failure in the sphere of European shipping. The fulcrum, as I see it, is represented by the European Union itself. Through the regulatory system that will be in force, the EU will decide whether the balance will shift towards success or tilt the other way towards failure.

Success, in my view, is represented by safeguarding the tonnage and ancillary services so assiduously created and maintained by Malta and other aspiring states like Cyprus in order to have a healthy European shipping industry and give Europe rediscovered pride in this particular area. This must naturally be balanced by appropriate and effective monitoring and the maintenance of acceptable standards.

What I would personally envisage as a failure on the EU's part, is letting the fruit of years of sacrifice and efforts by registries such as Malta and Cyprus, escape from its comfortable reach and allow other regions of the world to take full advantage of Europe's 'generosity'.

This scenario has indeed led to a situation where international competitive mechanisms allowing fiscal advantages have been recognized, in tandem with an overall dilution of opposition to incentives offered by open registers in general.

The former was mainly done by issuing revised guidelines related to State Aid to maritime transport whilst the latter step was rendered necessary in the light of similar incentives being offered by international and second Registers within the European Union itself.

The fact that offshore registers operated by European states from their dependencies or colonies are being treated by the EU as falling outside the territorial boundaries of the Union clearly goes to show that the EU is diluting its opposition to the open registry system. Moreover, land-locked Luxembourg, a founding member of the EU, is also currently offering fiscal incentives similar to those enjoyed in the typical open registers.

Several European member states are also opening and operating second registers which offer fiscal and employment-related benefits. One would instinctively think that these are in blatant non-compliance with EU law but in fact they have received their blessing from the European Court of Justice which established, for instance, that the German Second Register is not in contravention of the European Union's Competition rules (*Firma Sloman Neptun Schiffahrts AG v. Seebetriebsrat Bodo Ziesemer, de la Sloman Neptun Schiffahrts AG*; Joined cases C-72/91 and C-73/91).

Several member states have now taken special measures to improve the fiscal climate for ship-owning companies which can, strictly speaking, be regarded as state aid. The 1997 Community Guidelines also state that the system adopted in some

member states replacing normal corporate tax regimes by a tonnage tax amounts to state aid. Tonnage tax, as the name implies, is tax paid according to the tonnage operated and is payable irrespective of the company's actual earnings. These fiscal incentives have been endorsed by the EU since they have the effect of guaranteeing employment in the maritime sector. The maximum level of state aid to be permitted is reached through a reduction to zero of taxation and social charges for seafarers as well as corporate taxation of shipping activities.

Malta's future, in the light of possible forthcoming accession to the European Union, holds many exciting challenges. One of these challenges, in line with the island's vision for growth and prosperity, is the continued success of its shipping industry in general. Malta unquestionably has the determination and potential to firmly strengthen its position as a hub for shipping services and to consolidate its position as a strong but also reputable flag. In addition to the considerable size of its Registry, Malta can also boast a wide gamut of shipping services, such as shipbuilding and ship repairs, Malta Freeport operations, as well as bunkering and supply services. Finally, the competent and efficient professional and administrative bodies involved in the local shipping scene must also be given their due importance since they have also contributed greatly to the success of the Maltese flag throughout the years.